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The Indonesian economy is now fairly open to foreign trade. As a result, Indonesia has much to gain, and little to lose, from a pro-active free trade position during tariff negotiations in the WTO. Indonesia, could, for example, offer to reduce its own tariff bindings in return for meaningful market opening measures in other countries, including tightening the requirements for anti-dumping duties. Reduced tariff bindings would have little impact on Indonesian industries since those bindings are very high and are far above actual tariffs.
The Pakmei'95 package, which is based on tariffs before 1995, has now been in affect for several years. The tariff targets for some items are zero since Indonesia was not producer of the items before May 1995. It is thus possible that the package will lead to tariffs that are higher for upstream products than for downstream products. This results in negative effective protection for some industries, making it more difficult for downstream producers in these industries to compete internationally. As a result, it may be necessary to review the final targets of Pakmei and to make adjustments for some tariff lines. If such a review is conducted, it is recommended that the principles underlying Pakmei be maintained. In other words, ***low and identical protection for all economic sectors should form the cornerstone of Indonesia's tariff policy in the future.***

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AN OVERVIEW OF INDONESIA'S TRADE POLICY DURING THE 1990'S

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May 2001

Note: The attached policy note summarizes Indonesia's trade policy reforms during the past decade. Many of these reforms were introduced as part of Indonesia's annual deregulation packages, and were undertaken unilaterally by Indonesia. Others were required of Indonesia by its international commitments. Since there has been some concern that trade policy reforms have proceeded too far and have resulted in tariffs that are too low, the note also examines whether there is evidence that tariff reductions have had a negative impact on Indonesia's trade balance.

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[1] The Partnership for Economic Growth (PEG) is a USAID-funded Project with the Government of Indonesia. The views expressed in this report are those of the authors and not necessarily those of USAID, the U.S. Government or the Government of Indonesia.

AN OVERVIEW OF INDONESIA'S TRADE POLICY DURING THE 1990'S

Over the past two decades, the Government of Indonesia has made a tremendous effort to integrate Indonesia into the world economy. This process began in the mid-1980s following the sharp drop in oil prices, and accelerated in the 1990's when the Government reduced international trade barriers substantially and opened up the economy to foreign investment. Multilaterally, Indonesia was an active participant in the Uruguay Round negotiations and was one of the first countries to ratify the WTO. It also agreed to one of the highest proportions of tariff bindings in the world. In APEC, Indonesia hosted the Leaders' meeting of 1995 and established itself as a leading proponent of APEC's long-term goal with the Bogor Declaration. Indonesia is also one of the few countries to lay out a schedule for achieving APEC's long term goal of freer trade.

Initially, the objective of Indonesia's more liberal trade policies was to restructure the economy by diversifying the trade sector away from its heavy dependence on oil. These policies were highly successful at attracting foreign investment in light, labor-intensive export industries. With rapid advances in new technologies and ever increasing global interdependence, the goals of trade policy have now shifted to the enhancement of Indonesia's industrial competitiveness and to moving up the value chain. Achieving these goals is likely to be one of the major challenges facing the Indonesia Government in the future.

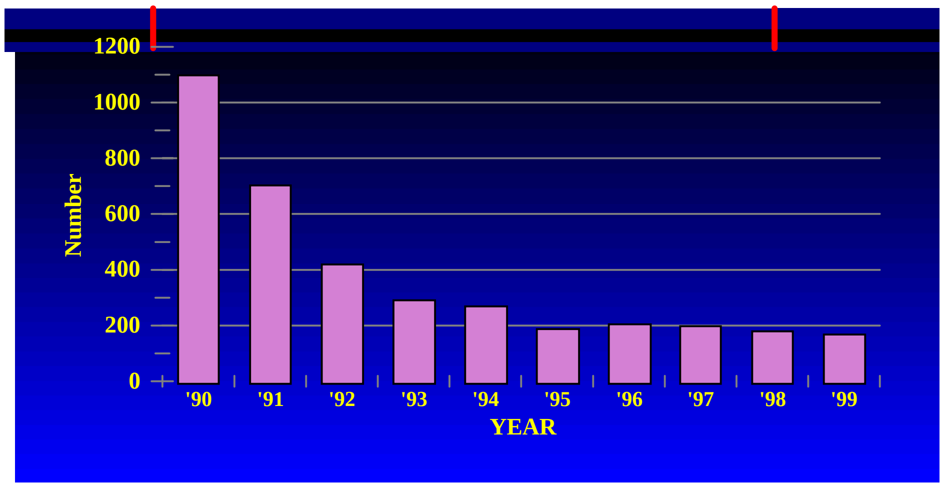
Trade policy reforms in Indonesia were implemented through a series of deregulation packages that were issued at least once each year and which aimed at converting non-tariff barriers into tariffs, rationalizing and reducing tariffs, and removing restrictions on foreign investment. A key feature of these reforms is that they were for the most part undertaken unilaterally. With few exceptions, Indonesia's international trade policy commitments, such as those with the WTO, ASEAN, and IMF, served only to complement reforms that Indonesia had in any case decided to undertake unilaterally.

> **Recommendation.** The Indonesian economy is now fairly open to foreign trade. As a result, Indonesia has much to gain, and little to lose, from a pro-active free trade position during tariff negotiations in the WTO. Indonesia, could, for example, offer to reduce its own tariff bindings in return for meaningful market opening measures in other countries, including tightening the requirements for anti-dumping duties. Reduced tariff bindings would have little impact on Indonesian industries since those bindings are very high and are far above actual tariffs.

Non-Tariff Import Barriers. In the late 1980s and early 1990s, non-tariff import barriers affected over one thousand tariff-lines in Indonesia's tariff code (Chart 1). Hundreds of these barriers, such as those pertaining to batik products, were superfluous in that they provided no protection. Imports would not occur even if the NTBs were removed.

In the early 1990s, the Government began to make its trade policy more transparent and efficient by converting NTBs to tariffs. As a result, the number of NTBs declined to about 200 in 1994. In following years, the number of NTBs continued to decline as Indonesia implemented its WTO commitments. Under those commitments, all NTBs for items in a country's schedule of commitments must be eliminated. Recently, Indonesia agreed with the IMF to eliminate Bulog's monopoly over imports of various food items. This change went beyond Indonesia's international obligations since it was not required by the WTO.

CHART 1: Indonesia's Non-Tariff Import Barriers



CHRONOLOGY

Year	Impetus for Change
1990-1992	Unilateral
1993-1994	Unilateral Plus Preparation for WTO
1995	Unilateral Plus WTO
1996	WTO, New LIMBAH Licenses Introduced
1997	WTO
1998-1999	WTO, IMF (Bulog Monopolies)

Tariffs. Tariff reform in Indonesia began in earnest in 1995 when Indonesia issued a far-reaching tariff reform package (Pakmei'95). This package, which was also adopted as part of Indonesia's APEC action plan, lays out a schedule of future tariff reductions (Table 1). Tariff reductions on individual line items alternate from year-to-year, depending on the level of the tariff before 1995. Long-term targets for the year 2003 are 0, 5, and 10 percent.

TABLE 1: Indonesia's Tariff Reduction Schedule (1995-2003)

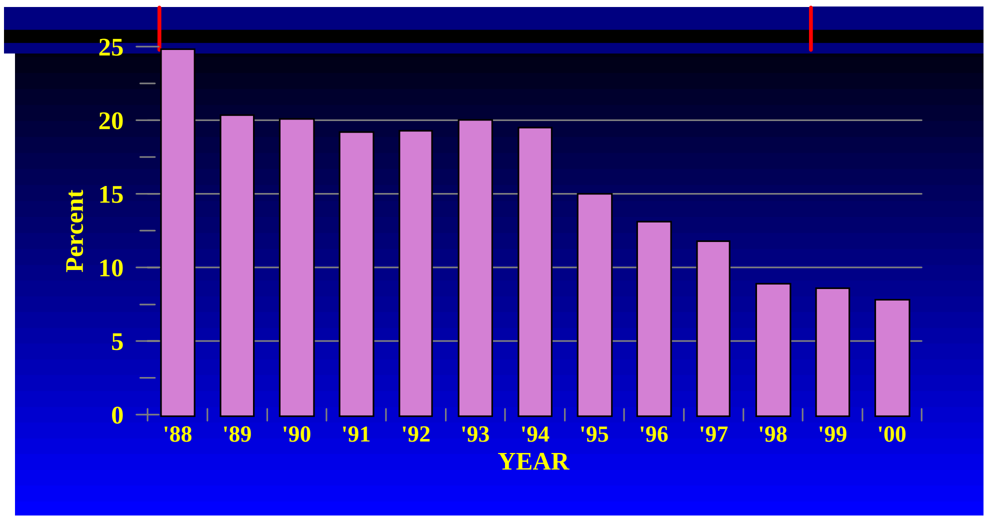
Tariff Before May 1995	1995	1996	1997	1998	1999	2000	2001	2002	2003
---Percent---									
0	0								0
5	5								Max 5
10	5								Max 5
15	10		5						Max 5
20	15		10		5				Max 5
25	20	15		10					Max 10
30	25	20		15		10			Max 10
35	30	25		20		15		10	Max 10
40	30	25		20		15		10	max 10
More than 45	30	25		20		15		10	max 10

As a result of Pakmei'95, Indonesia's average tariff has declined from almost 20 percent in 1994 to less than 8 percent in year 2000 (Chart 2). With few exceptions, all of the tariff reductions were a unilateral decision by Indonesia. The exceptions are the elimination of surcharges on steel in 1995, which was required by the WTO, and the reduction of agricultural tariffs in 1998, which was required by the IMF.

- Although Pakmei has led to a substantial reduction in Indonesian tariffs, there have been delays in reducing many tariff lines.[1] As a result, Pakmei should be viewed as a guideline for future tariffs, rather than a binding legal obligation. Only recently, in its memorandum of understanding with the IMF, did Indonesia bind itself to the strict implementation of Pakmei.

[1] In addition, certain sectors were either exempted from tariff reductions or were subject to separate tariff reductions schedules (e.g. agriculture, chemicals, metals, alcoholic beverages, and autos). In subsequent years, the Government developed separate schedules for most of these sectors. As an example, a special autos package was issued by the Government in 2000.

CHART 2: Indonesia's Average Unweighted Tariff



CHRONOLOGY

Year	Impetus for Change
1988-1994	Unilateral
1995	Pakmei'95 plus WTO Elimination of Surcharges
1996	Scheduled under Pakmei'95
1997	Scheduled under Pakmei'95
1998	Scheduled under Pakmei'95 plus IMF (Agriculture)
1999	Scheduled under Pakmei'95
2000	Scheduled under Pakmei'95 plus Special Autos

The Advantages of Pakmei'95. The principal behind Indonesia's Pakmei'95 tariff package is low, similar protection for all economic sectors. By moving tariffs closer together, Pakmei will therefore eliminate many of inter-industry distortions caused by tariff policy. This can become a great problem in developing countries since as development occurs, industrial linkages expand tremendously. Consequently, protection of one industry inevitably harms the development of another. By laying out a schedule of future tariffs, Pakmei also provides decision-making information to investors, and the business community more generally, on the future trade policy of the government.

> Recommendation: The Pakmei'95 package, which is based on tariffs before 1995, has now been in affect for several years. The tariff targets for some items are zero since Indonesia was not producer of the items before May 1995. It is thus possible that the package will lead to tariffs that are higher for upstream products than for downstream products. This results in negative effective protection for some industries, making it more difficult for downstream producers in these industries to compete internationally. As a result, it may be necessary to review the final targets of Pakmei and to make adjustments for some tariff lines. If such a review is conducted, it is recommended that the principles underlying Pakmei be maintained. In other words, ***low and identical protection for all economic sectors should form the cornerstone of Indonesia's tariff policy in the future.***

Tariff Reform and Trade. The Indonesian Government's decision to reduce import barriers reflects a more fundamental policy goal of an outward oriented trade policy. Such a policy has led to mounting concerns about increased imports due to the lack of competitiveness of Indonesian industries. Although enhancing competitiveness is indeed a valid policy goal, increased protection is not a proper policy instrument for achieving that goal since protection reduces competitiveness, rather than increases it.[2] Furthermore, there are no signs that the reduction of import barriers by Indonesia has had a detrimental affect on import competing sectors during the past couple of years.

Table 2 below shows Indonesia's average tariffs for the years 1994 and 1998, and the change in

[2] In those instances where imports have caused serious harm to Indonesia's domestic industry and there is dumping or subsidies in foreign countries, Indonesia can use the various safeguard and anti-dumping provisions of the WTO to increase protection.

Indonesia's trade surplus (or deficit) between 1994 and 1999, where the change is defined as:

- (Exports minus Imports in 1999) minus (Exports minus Imports in 1994).[3]

A positive number indicates that Indonesia's trade situation has improved between 1994 and 1999. A negative number indicates that the trade situation has deteriorated.

As indicated in the Table, there has been a substantial reduction in tariffs for all economic sectors. For the entire non-oil/gas sector, the average tariff has declined by about 50 percent – from 19.6 percent in 1994 to 9.5 percent in 1998. Yet in spite of this decline, Indonesia's trade surplus improved by $17.7 billion dollars between 1994 and 1999. Improvements occurred in almost every economic sector.

- The improvement in Indonesia's trade surplus is due mostly to the economic crisis and the decline in imports. This reflects the fact that ***a country's trade balance is determined not so much by tariffs, but by macro economic factors -- particularly the relationship between savings and investment.*** For example, the United States presumably has very competitive industries, yet runs a huge trade deficit. This deficit is financed by a flow of foreign savings into the U.S. economy. On the other hand, many people argue that Indonesian industries cannot compete internationally and need protection. Yet, there has been a huge increase in Indonesia's trade surplus. This increase is due primarily to the movement of foreign savings out of the Indonesian economy.

For those economic sectors in which there has been a substantial decline in the trade surplus (e.g. rubber, plywood, footwear, jewelry), the decline was due to a drop in exports -- not to an increase in imports. Only in a few cases (cereals and sugar), was the deterioration in the trade balance been due to an increase in imports.

- It is difficult to determine whether protection has increased or decreased for cereals and sugar since both commodities have been subject to non-tariff import barriers for many years (Table 2). A rough guess is that protection has increased for rice, but declined for sugar. In the case of rice, Bulog attempted to keep rice prices at parity with world prices during the early 1990's. Now, the ad valorem equivalent of the current specific tariff on rice is approximately 30 percent.

[3] We use a later date (1999) for imports/exports than for tariffs (1998) because of the lag between a change in tariffs and possible impacts on trade.

TABLE 2: Indonesia's Tariffs and Non Oil/Gas Trade (1994-1999)

Product Description (SITC Code)	Average Tariffs 1994	Average Tariffs 1998	Difference	Imports 1994	Imports 1999	Imports Annual Growth	Exports 1994	Exports 1999	Exports Annual Growth	Change in Trade Surplus 1994 to 1999
	------------Percent----------			---Mill. US $---			---Mill. US $---			Mill. US $
Total Non Oil/Gas	**19.6**	**9.5**	**-10.1**	**29,577**	**20,290**	**-7.3%**	**30,360**	**38,756**	**5.0%**	**17,683**
Mining/Minerals	**8.9**	**6.4**	**-2.5**	**1,005**	**665**	**-7.9%**	**2,383**	**3,510**	**8.1%**	**1,467**
Metals Ores/by-Products (28)	3.8	3.6	-0.2	345	226	-8.1%	1,148	1,480	5.2%	451
Coal (32)	3.6	4.4	0.7	18	14	-5.8%	830	1,306	9.5%	481
Non-Ferrous Metals (68)	10.4	7.4	-3.1	642	426	-7.9%	405	724	12.3%	535
Agriculture	**22.8**	**8.4**	**-14.4**	**2,678**	**3,920**	**7.9%**	**6,442**	**6,789**	**1.1%**	**-895**
Rubber (23)	6.1	5.3	-0.8	138	93	-7.5%	1,275	865	-7.5%	-365
Fish/Shrimp (03)	26.0	5.2	-20.8	16	25	10.2%	1,582	1,556	-0.3%	-35
Coffee, Tea, Cocoa, Spices (07)	24.8	4.9	-20.0	18	76	33.2%	1,297	1,310	0.2%	-45
Vegetable Oils (40,42,43)	13.2	5.0	-8.2	101	29	-21.9%	1,373	1,828	5.9%	527
Fruits/Vegetables (05)	26.1	5.0	-21.1	197	147	-5.7%	304	384	4.8%	131
Beverages/Tobacco (11,12)	105.2	88.4	-16.8	142	154	1.7%	138	232	10.9%	82
Animal Feed (08)	8.2	3.9	-4.4	417	274	-8.0%	157	90	-10.5%	76
Cereals and Preparations (04)	NTB	NTB	???	922	1,899	15.5%	58	61	1.0%	-974
Sugar and Preparations (06)	NTB	NTB	???	63	559	54.9%	73	68	-1.4%	-501
Other (00,01,02,09,21,22,41,29)	16.2	5.2	-11.0	666	664	-0.1%	186	395	16.2%	211
Forestry	**17.5**	**4.7**	**-12.9**	**934**	**963**	**0.6%**	**5,953**	**6,172**	**0.7%**	**189**
Plywood (634)	20.9	7.8	-13.0	24	20	-3.8%	4,125	2,570	-9.0%	-1,551
Other Wood Man. (rest of 63)	23.8	11.9	-11.9	9	3	-19.8%	708	852	3.8%	151
Pulp (25)	10.0	3.3	-6.7	614	647	1.1%	138	482	28.5%	311
Paper (64)	22.1	7.8	-14.3	247	221	-2.2%	594	1,950	26.8%	1,382
Other wood (24)	12.4	0.5	-12.0	39	72	12.8%	389	318	-4.0%	-104
Other Manufactures	**19.6**	**10.3**	**-9.3**	**24,960**	**14,741**	**-10.0%**	**15,582**	**22,286**	**7.4%**	**16,922**
Textiles (65)	25.0	12.5	-12.5	1,170	866	-5.8%	2,498	3,158	4.8%	964
Textile Fiber (26)	6.8	5.1	-1.6	953	836	-2.6%	79	104	5.8%	142
Garments (84)	35.8	18.9	-16.9	20	28	6.7%	3,206	4,025	4.7%	812
Footwear (85)	33.6	16.8	-16.7	122	65	-11.9%	1,888	1,697	-2.1%	-135
Furniture (82)	31.2	15.0	-16.2	29	8	-22.6%	783	1,324	11.1%	561
Organic Chemicals (51)	6.9	5.0	-1.9	1,610	1,880	3.2%	335	864	20.9%	258
Fertilizer (27, 56)	4.2	3.1	-1.1	317	446	7.1%	286	271	-1.1%	-144
Essential Oils (55)	22.8	12.9	-9.9	221	189	-3.0%	152	303	14.7%	182
Other Chemicals (52, 53, 54, 59)	8.5	5.5	-3.0	1,770	1,479	-3.5%	214	416	14.2%	493
Plastics (primary/other) (57,58)	16.9	12.1	-4.8	1,178	723	-9.3%	131	676	38.7%	1,000
Cement, Glass, Ceramics (66)	21.8	7.2	-14.6	331	142	-15.5%	322	704	16.9%	570
Iron/Steel (67)	11.2	9.4	-1.8	1,656	988	-9.8%	309	493	9.8%	852
Metal Manufactures (69)	20.2	11.8	-8.4	677	439	-8.3%	328	515	9.4%	425
Consumer Electronics (76)	23.9	12.3	-11.6	759	208	-22.8%	1,472	1,500	0.4%	579
Data/Office Machinery (75)	17.1	3.3	-13.8	176	169	-0.8%	300	1,203	32.0%	910
Electrical Machinery (77)	16.8	7.6	-9.2	1,767	663	-17.8%	596	1,400	18.6%	1,908
General Machinery (74)	12.7	3.3	-9.4	2,214	1,252	-10.8%	144	251	11.7%	1,069
Other Machinery (71,72, 73)	8.8	2.7	-6.1	5,397	2,252	-16.0%	90	488	40.4%	3,543
Road vehicles transport (78,79)	50.2	40.8	-9.3	3,136	1,165	-18.0%	448	563	4.7%	2,086
Rubber Articles (62)	21.7	11.5	-10.2	117	169	7.8%	135	324	19.2%	136
Leather/Travel Goods (61,83)	17.7	6.6	-11.1	355	178	-12.8%	117	213	12.7%	272
Plastic Articles (893)	34.4	23.4	-11.0	68	54	-4.5%	126	192	8.8%	80
Toys/Games (894)	39.0	17.8	-21.2	29	12	-17.0%	248	290	3.1%	59
Jewelry (897)	36.2	18.2	-18.0	5	1	-20.6%	726	175	-24.8%	-548
Other Manufactured Goods of 89	25.7	11.3	-14.3	222	173	-4.8%	252	446	12.1%	243
Photo.equip/other Manuf. (81,87,88)	16.0	8.0	-8.0	646	353	-11.4%	250	341	6.4%	384
Gold/Special Transactions (93,97)	6.7	4.2	-2.5	16	1	-38.4%	147	352	19.2%	220